Shyam Sunder
ACCOUNTANCY

SEC’s mandate will lead to a monopoly

If US companies are required to use international accounting standards, it will effectively create a single set of standards used around the world by taking away the one system – US GAAP – with the influence and significance to challenge the international rules.

According to the Securities and Exchange Commission, which has proposed a roadmap for companies to transfer to the new international financial reporting standards, the move would integrate the world’s capital markets by providing a common high-quality accounting language, and increase confidence and transparency in financial reporting.

These are lofty and desirable goals. But why mandate a monopoly? The top-down imposition of a single set of standards will move us away from, not closer to, the SEC’s goals.

First, principles-based standards are less enforceable. By allowing more room for judgment of managers and auditors, they introduce greater diversity and result in fewer, not more, comparable reports.

Second, the SEC does not explain what it means by “high quality”. Qualities such as decision usefulness, reliability, timeliness, and verifiability often conflict: expensing the value of employee stock options is a high-quality standard for some and low for others.

Third, standard-setters try to devise new rules to account for market innovations. Identifying which accounting rule is better calls for experimentation. At the moment, US standard-setters can look overseas; with the proposed worldwide monopoly of IFRS, comparisons of alternative treatments will become impossible.

Fourth, the economic substance of business transactions depends on their legal, commercial, market, governance and managerial environment. Even within the US, the same set of accounting rules does not yield similar results across industries. Greater comparability of financial reports of all public firms across more than 100 countries is a pipedream. Within the European Union, accountants find little comparability between the financial reports of, say, Italian and Dutch firms – and both report under IFRS. Many Asian countries embraced IFRS to attract foreign capital but plan to use their own interpretations. So much for comparability.

Fifth, unlike a uniform system of weights and measures, the conduct of business changes in response to the accounting rules applied.

The metaphor of natural languages is more appropriate, where the meaning of words arises from their usage, and ambiguity and multiplicity of meanings are norms, not exceptions. Esperanto is an example of a failed effort to replace the world’s languages with a single language.

The SEC would better protect investors by allowing two or more standard-setters to compete for royalty revenues from companies that could choose one brand of standards to prepare their reports. Standards competition produces efficient results in fields such as appliances, bond ratings, higher education and stock exchanges.

Investor or consumer self-interest, combined with some regulatory oversight, keeps such competition from racing to the bottom. It also keeps the door open for faster response to financial engineering and limits the complexity of the standards.

Allowing a worldwide monopoly to a single manufacturer serves neither the public nor the manufacturer for long. Development of IFRS is good news; a government mandate to grant it a monopoly is not.

Shyam Sunder is James L. Frank Professor of Accounting, Economics and Finance at Yale School of Management.

www.ft.com/accountancy